

**ST 00-11**

**Tax Type: Sales Tax**

**Issue: Books And Records Insufficient  
Unreported/Underreported Receipts (Fraud Application)**

**STATE OF ILLINOIS  
DEPARTMENT OF REVENUE  
ADMINISTRATIVE HEARINGS DIVISION  
CHICAGO, ILLINOIS**

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**THE DEPARTMENT OF REVENUE  
OF THE STATE OF ILLINOIS,**

**v.**

**“ANAHEIM LIQUORS, INC.”**

**Taxpayer**

**No. 98-ST-0000  
IBT: 0000-0000  
NTL: SF- 980000000000  
SF- 980000000001**

**Christine O’Donoghue  
Administrative Law Judge**

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**RECOMMENDATION FOR DISPOSITION**

**Appearances:** Mr. John Alshuler, Special Assistant Attorney General for the Illinois Department of Revenue; Mr. Kenneth Rosenberg of Dordek, Rosenberg & Associates for “Anaheim Liquors Inc.”

**Synopsis:**

This matter arose pursuant to “Anaheim Liquors” (“taxpayer”) protest of the Notices of Tax Liability (“NTL”) issued by the Illinois Department of Revenue (“Department”) following an audit of the period July, 1993 through April, 1996. Counsel for the parties have agreed that the issues to be resolved at the hearing were whether the taxpayer can substantiate certain deductions from its gross receipts and whether the markup used by the Department in the audit accurately reflects the markup utilized by the taxpayer during the audit period. *See*, Orders dated 5/26/99, 7/13/99. After a review of

the evidence adduced at hearing, it is my recommendation that the Notices of Tax Liability be finalized as revised by the abatement of the fraud penalty.

**FINDINGS OF FACT:**

1. The Department's *prima facie* case was established by the admission of two Notices of Tax Liability SF-980000000000 and SF-980000000001 and the relating corrections of returns and/or determination of tax due for the period of July 1, 1993 through April 30, 1996 showing a total liability of tax, penalty and interest (calculated through September 17, 1998) of \$175,805.00. Dept. Group Ex. No. 1.
2. "Mickey Finn" was the owner of "Anaheim Liquors, Inc." during the audit period. Tr. p. 41.
3. Mr. "Jack Daniels" was the accountant for "Anaheim Liquors" during the audit period. Tr. p. 13. During the audit, "Daniels" worked with the Department auditor. Tr. p. 13.
4. The auditor reported total sales of \$1,251,000 for the audit period. Tr. p. 20; Taxpayer Ex. No. 1.
5. The number printed on the top of each Z tape is the company's accumulated sales. Tr. p. 62.
6. The auditor calculated a day's sales by subtracting the previous day's cumulative sales total on the cash register Z tape from the current day's cumulative sales total. She compared this difference to the sales reported by the taxpayer. The auditor uncovered discrepancies between the reported sales and the "Z tape" sales. Tr. p. 34. Through this analysis, the auditor determined that the taxpayer had

underreported its sales by 54.22% (\$440,001) for the 1994 period. Dept. Ex. No. 2.

7. During the audit, the auditor reviewed the control numbers on the 1994 Z tapes and determined that the taxpayer was missing a Z tape from each business day. Dept. Ex. No. 2; Tr. pp. 34, 61.
8. The taxpayer did not keep books and records other than its cash register Z tapes and some purchase invoices. Tr. p. 60; Taxpayer Ex. Nos. 4 & 5.
9. The accountant reviewed the client's records and prepared a summary analysis of "Anaheim Liquors'" taxable sales for the period of December, 1993 through November, 1994. Tr. p. 16. This time period was the auditor's sample year from which she calculated the underreported percentage of sales and the tax liability for the entire audit period. Tr. p. 20.
10. In his analysis, the accountant estimated that the markup used by the taxpayer was approximately 20%. Taxpayer Ex. No. 3; Tr. pp. 24, 25. The accountant did not determine the taxpayer's amount of theft or spoilage for the audit period but rather estimated these figures based upon his experience. Tr. p. 24.
11. The summary analysis prepared by the taxpayer's accountant breaks the sales into several categories: cash purchases for the month, the monthly lottery receipts and the "actual" or taxable sales. Tr. pp. 63, 64; Taxpayer Ex. No. 3.
12. At hearing, the taxpayer did not provide any documents establishing the amount of lottery sales or cash purchases made during the audit period. *See*, Taxpayer Ex. Nos. 1-4.

13. Although the accountant prepared the taxpayer's income tax returns, he did not know the taxpayer's cost of goods sold for the audit period. Tr. p. 71.
14. At the conclusion of the audit, the taxpayer requested a review by the Informal Conference Unit ("ICU"). Tr. p. 29. During this review, the conferee requested copies of purchase invoices, cancelled checks, check registers, bank statements and an analysis of what the taxpayer's cash payouts were for the two test months agreed to during the course of the discussions at ICU. Tr. p. 29.
15. The taxpayer provided the ICU conferee with cash register tapes ("Z tapes") and the summary sheet. Tr. p. 30.

#### **CONCLUSIONS OF LAW:**

The Department established its *prima facie* case by the introduction of its corrections of returns into evidence under the certificate of the Director. The Department's *prima facie* case is a rebuttable presumption. Copilevitz v. Department of Revenue, 41 Ill. 2d 154, 157 (1968), however, the taxpayer cannot overcome the presumption merely by denying the accuracy of the Department's proposed assessment. A.R. Barnes Co. v. Department of Revenue, 173 Ill. App. 3d 826, 833 (1<sup>st</sup> Dist. 1988). The taxpayer must present evidence that is consistent, probable and identified with its books and records to show that the proposed assessment is not correct. Fillichio v. Department of Revenue, 15 Ill. 2d 327, 333 (1958).

"Anaheim Liquors" asserts that it did not underreport its receipts and further argues that the auditor used an unreasonable markup figure in determining the audit results in this case. While the Department's audit methodology must meet a minimum standard of reasonableness, (Fillichio v. Department of Revenue, 15 Ill. 2d at 333; Masini

v. Department of Revenue, 60 Ill. App. 3d 11, 14 (1978)), it is the taxpayer's burden to show that the audit method used failed to meet that standard. *See, Vitale v. Department of Revenue*, 118 Ill. App. 3d at 210, 213 (3d Dist. 1983).

At hearing, Mr. "Finn" the owner of "Anaheim Liquors" and Mr. "Daniels", taxpayer's accountant, testified after the Department presented its *prima facie* case. Mr. "Finn" described the daily business operations of "Anaheim Liquors" and explained how he closed out the cash register at the end of each business day. In support of taxpayer's case, it submitted the daily Z tapes and purchase invoices from 1994. Taxpayer Ex. Nos. 4 & 5.

The audit liability was determined through the auditor's review of the taxpayer's cash register Z tapes. Dept. Ex. Nos. 1 & 2. During the audit, the auditor determined that only the 1994 Z tapes were reliable because they had sequential "ring" numbers that established that she had a complete set of Z tapes in her possession. Dept. Ex. No. 2. As a result, the auditor used the 1994 sales as a sample, determined that the taxpayer underreported its sales by 54.22% for the 1994 period and applied this underreporting percentage to "Anaheim's" reported sales for the other tax years. *See*, Dept. Ex. Nos. 1 & 2. By examining the ring numbers, the auditor determined that a Z tape was missing from each business day during 1994. Dept. Ex. No. 2.

The taxpayer introduced its own summary worksheet of the period reviewed by the auditor, December, 1993 through November, 1994. Taxpayer Ex. No. 3. At hearing, the taxpayer attempted to justify why it is missing daily Z tapes by outlining the procedures Mr. "Finn" used to close the cash register each day. "Finn" contends that each day he used the cash register as a calculator to reconcile the cash in the register to the

sales reflected on the daily Z tape. He did this by adding the amount of lottery sales and the cash purchases (cash out) to the sales number stated on the Z tape. He then threw away the Z tape that reflected this daily reconciliation. Tr. p. 61. Thus, the taxpayer argues that by using the cumulative sales amounts on the Z tapes, the auditor incorrectly included lottery sales and cash purchases in its taxable sales base.

On Taxpayer's Summary Worksheet (Taxpayer Ex. No. 3) the accountant added the lottery sales and cash purchases to what he believes is "Anaheim Liquors'" correct 1994 taxable sales amount. Taxpayer Ex. No. 3. This total amount was compared on a monthly basis to the sales amount calculated by the auditor. The summary sheet reflects that in some months the amounts are close, however, they are not identical in any of the months reviewed. More importantly, this comparison does not support the taxpayer's position because the alleged steps taken by the taxpayer would simply not reconcile the cash drawer to the Z tapes.

The problem with the taxpayer's analysis lies in several areas. First, I have reviewed the 1994 Z tapes and the purchase invoices submitted into evidence by the taxpayer and there are no documents that prove up the amount of lottery sales made during any month. Secondly, the taxpayer failed to prove the exact amount of cash purchases made during 1994. Taxpayer did submit purchase invoices for 1994, the basis for its summary sheet, however, a review of these invoices reflects that some were paid by check and quite a few of them do not indicate whether they were paid for by cash or check. Finally, although taxpayer notes on taxpayer's Exhibit No. 3 that the auditor did not account for some cash pay outs such as payroll, it has not provided any payroll records to substantiate its claim.

Furthermore, taxpayer's arguments are illogical. If taxpayer did attempt to reconcile the cash on hand at the end of a business day with the sales as reflected on the cash register tapes, he would not succeed by adding the lottery sales and cash purchases for that day. If taxpayer is attempting to argue that during a business day, lottery sales were rung up on the same register as other sales, a person would subtract the daily amount of lottery sales from the sales reflected on the daily Z tape to calculate the taxable sales. Further, to reconcile the taxable sales amount to the cash on hand the taxpayer would add the cash on hand to the amount of cash paid out that day for purchases.

At hearing, the taxpayer contended that it had Z tapes for the entire period yet the auditor only used the 1994 tapes. Tr. pp. 20, 21. The Department did not, however, dispute that the taxpayer had cash register tapes for years other than 1994, it stated that only the 1994 tapes were reliable because they had sequential ring numbers. Thus, the auditor could ensure that she had a complete year of Z tapes for 1994. Because of this, the auditor chose to develop an underreporting percentage for 1994 and apply it to the remaining years. Dept. Ex. No. 2. Importantly enough, the taxpayer did not submit Z tapes for years other than 1994 for review, nor did it dispute that the remaining Z tapes did not have control numbers. Thus, I can only conclude that the auditor used her best judgment and information in conducting the audit and the Department's sampling techniques were necessary because the taxpayer's records were patently unreliable. *See, Vitale, supra.*

The question of whether an audit determination meets a minimum standard of reasonableness should not be posed until a taxpayer has introduced credible evidence that the tax adjustment proposed failed to meet these standards. The Department is not

required to prove the reasonableness of its audit determinations before the statutory presumption of correctness attaches. Vitale v. Department of Revenue, 118 Ill. App. 3d 210 (3d Dist. 1983). It is the taxpayer's burden to prove that the auditor's error projections and its method of calculating the 1991 sales is clearly incorrect. Merely denying the accuracy of the Department's assessments, offering alternative procedures or arguing its audit methodology is flawed does not overcome the Department's *prima facie* case. A. R. Barnes & Co., *supra*; Mel-Park Drugs v. Dept. of Revenue, 218 Ill. App. 3d 203 (1<sup>st</sup> Dist. 1991). The auditor reviewed the taxpayer's own books and records to determine the audit liability. Although taxpayer's alleges that the auditor's determination is incorrect, it has not supported its contentions with corroborating documentation. Thus, the taxpayer has failed to rebut the *prima facie* correctness of the Department's Correction of Returns. A.R. Barnes, *supra*.

Taxpayer also disputed the mark-up used by the Department. The record reveals, however, that the amounts stated on the taxpayer's own cash register tapes are the basis of the NTLs not marked-up purchase information. Thus, its arguments with respect to the mark-up are irrelevant.

Lastly, it must be determined whether the under-reporting of sales as determined by the Department was due to fraud. Where civil fraud under Section 4 of the Retailers' Occupation Tax Act (35 ILCS § 120/4) is alleged, the Department must show intent. Intent for this purpose can be shown by circumstantial evidence. Vitale, at 218. In the Vitale case, the court found the necessary intent from a number of facts, including the following: the taxpayer had understated his gross receipts by as much as 200%; in one year the taxpayer's purchases exceeded his sales by 46%; finally, the taxpayer failed to



maintain business records. Vitale, at 213. In the instant case, the auditor found that the taxpayer underreported its sales by 52% in 1994, the sample year. Although significant, the taxpayer did show that it kept purchase invoices and cash register Z tapes for 1994, further, it is undisputed that the taxpayer did have some cash register tapes for the other audit years. In sum, a review of the record reveals that the Department has not come forward with sufficient evidence to clearly and convincingly prove the taxpayer's fraudulent intent, therefore, the fraud penalties should be abated.

Wherefore, for the reasons stated above, it is my recommendation that the Notices of Tax Liability be finalized as revised by the abatement of the fraud penalty.

Date: April 24, 2000

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Administrative Law Judge